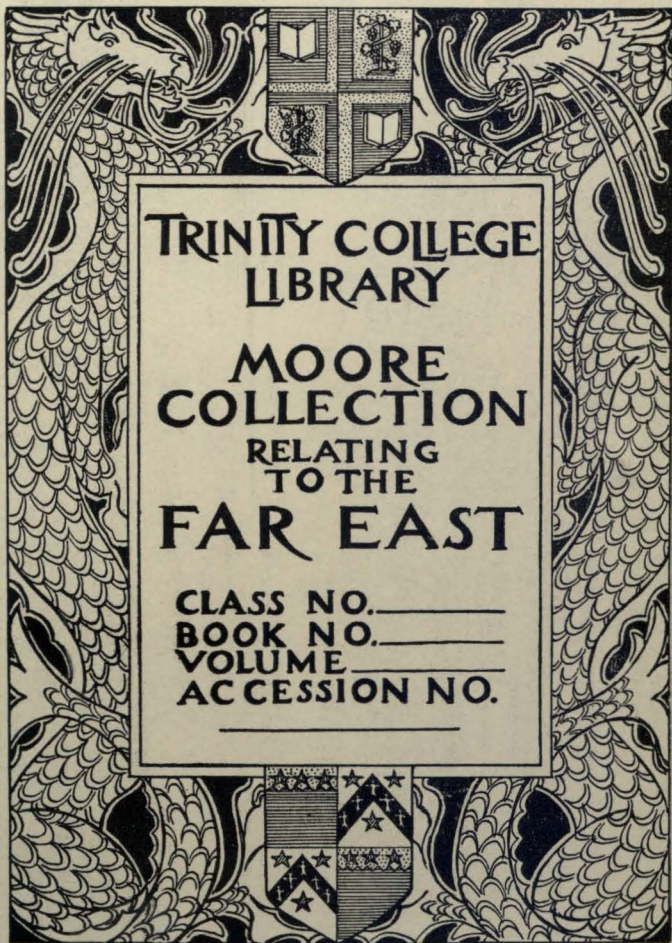




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Memorandum
for the
National Commission for the Study of Financial Problems

**The Financial Reconstruction of China
and
The Consolidation of China's Present Indebtedness**

by

G. PADOUX
Adviser to the Chinese Government

PEKING
January 1923.

Na-Che-Pao

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**The Financial Reconstruction of China
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I.— The Constitutional and Political Problem.

The financial reconstruction of China is not primarily a financial problem. It is a constitutional and political question, the solution of which lies in the readjustment of the relations between the Provinces and the Central Government.

The Manchu regime had evolved an elaborate and well balanced system of internal administration which left to the Provinces a large autonomy, whilst affirming the superior authority of the Throne. All officials down to the Magistrate were appointed from Peking, under two very strict rules, viz.: 1° that no person could hold office in his native province, and 2° that the term of office was limited to three years, with only one possible extension. The Government was very careful to select as Viceroys or Governors personages devoted to the Imperial Family, and, in the distribution of offices, to keep the balance even between Chinese and Manchus, as well as between the various

provincial parties or clans. The consequence was that the governing body of a Province would always consider themselves as representing the Central Government, and would not think of identifying with the population under their control, or supporting provincial interest against Imperial prerogative. Their task was facilitated by the granting of wide powers which enabled them to settle direct most of the local questions. Once the Imperial authorities in Peking were satisfied with the loyalism of the holders of the main official positions, they would leave them a free hand in the administration of the province, provided only that the taxes and provincial contributions be duly remitted every year to the Central Treasury.

When additional revenue was required for meeting new obligations, international or domestic, an equitable understanding would always be reached, the provinces showing the same consideration for the needs of the Central Government as Peking would show for the local interests.

The foundations of the system were shattered by the 1912 revolution. The whole structure was built on the devotion of the Viceroys and Governors to the Emperor. The Emperor abdicated. Most of the high officials resigned or disappeared. A Provisional Republican constitution was promulgated which treated China as a highly centralized State, thus ignoring the main constitutional problem of the country. The Central Government was left unarmed, with practically no power of control over the provincial authorities, whilst the provinces were being given local Assemblies through which they could develop separatist tendencies. The old machinery kept in motion for some time, but soon the provincial chiefs, whether Civil Governors, or Military Governors, or General Inspectors, found that it was more profitable to side with the Provinces than with the Central Government, seeing that in fact the money was coming from the Provinces and that it was easier for the provinces to live apart of the Central Government than for the Central Government to dispense with the support of the Provinces.

Thus developed the present condition of affairs. It cannot improve materially unless the nature of the relations between the Central Government and the Provinces be clearly defined (which is the constitutional side of the problem), and unless the new distribution of power between the Provinces and the Central Government is accepted by the provincial authorities or forced upon them (which is the political side of the problem). No reduction of the army, no disbandment of the superfluous soldiery is worth being undertaken so long as the Tutchuns, Civil Governors, or other such provincial chiefs can defy the orders of the Government, seize the revenue, and recruit fresh troops at their own will. Neither can the finances of the Government be put on a sound basis if the proceeds of Government taxation continue being appropriated by the local military or civil authorities.

II.— *The Comparative Situation of China.*

Happily for China, the resources of the country are so great and the charges so light that even a moderate improvement in the political situation would remove many of the financial difficulties.

With more than 400 millions inhabitants, it is doubtful whether the governmental, provincial and local taxation in China proper exceeds 500 millions dollars a year, an average of \$1,20 per head. It is almost nothing when compared with taxation in the other parts of the world. Precise figures cannot be worked out because of the fluctuations in the rates of exchange and because the budgets of most of the foreign Powers are still subject to important variations from year to year. But a rough calculation, which is quite sufficient for our purpose, shows that the annual *per capita* revenue derived from taxes and duties in the following countries, reduced into silver, amounts to:

Great Britain	\$ 170
France	\$ 90
Italy	\$ 24
Belgium	\$ 30
United States (Federal taxation only)	\$ 120

Of course, fully developed States of Europe and America can pay higher taxation than China. But turning to the countries of Asia which are lying on the coast of the Pacific and whose conditions may compare with those obtaining in China, the figures are, *per capita*:

Japan	\$ 16,00
Philippines	\$ 7,50
French Indochina	\$ 5,50
Siam	\$ 9,50
Dutch East Indies	\$ 15,00

The Chinese average of \$ 1,20 is about one fifth of the average taxation paid in French Indochina, and one eighth of the average taxation paid in Siam. Yet, the population of China is more industrious, more hard working, and has more resources, agricultural, commercial, industrial and mineral than the population of French Indochina or Siam. The Chinese nation feels the burden of taxation not so much because it is excessive than because the system is cumbersome, because it works injustice on many classes of citizens, because it is made the pretext for all sorts of malprac-

tices, and above all because the taxpayer is given very little in return for what he pays. If slightly reformed and properly controlled, and if its proceeds were used for the real benefit of the people, a nett revenue of nearly 450 millions dollars could easily be collected.

National debts are at present a crushing burden on most of the European and American Powers. Their *per capita* ratio reaches appalling figures in several countries:

Great Britain	\$ 1,440
France	\$ 1,310
United States (Federal debt only)	\$ 433
Belgium	\$ 312
Italy	\$ 190
Japan	\$ 50

Now, the present public debt of China, domestic and foreign (exclusive of railway debts which are not included in the above foreign statistics) is under 1,900 millions silver dollars, or *Four Dollars Seventy Five cents* per head, two hundred and fifty times less than the *per capita* ratio of the British and French public debt.

The service of the secured Chinese debts, domestic and foreign, requires at the most 95 millions dollars a year. The consolidation of the unsecured debts, as shown below, may require during the next years from 40 to 45 millions a year. That is to say a maximum grand total of 140 millions dollars per year leaving 300 millions. or 25 millions per month, for the governmental, provincial and local expenditure. This is quite enough for making a start in efficient administration and balancing a reasonable budget. More money will of course be soon required for police, education, hygiens, agriculture, trade and otherwise fostering the economic development of the country. A few reforms in taxation would at once bring in the necessary revenue seing that for every *ten cents* increase in the *per capita* ratio the Treasury would receive an additional 40 millions dollars a year.

III.—The unsecured indebtedness.

The first step towards financial reconstruction is the settlement of the present unsecured indebtedness of the Chinese Government. For some of these debts the creditors have succeeded in getting irregular payments. For most of them neither interest nor capital had been paid for one year or more. The situation affects the local financial market, since all the Chinese Banks are on the list of the creditors and are badly in need of the money owing to them. It affects still more the credit of China at home and abroad. It blocks every possible

attempt of the Chinese Government to raise loans for constructive purposes at reasonable rates. It puts the Ministry of Finance in the most difficult position. Some sort of remedy must be found if national bankruptcy is to be avoided.

In the statistics compiled in October 1922 by the Ministry of Finance, the unsecured indebtedness is reported as follows, interest being calculated up to the end of the year 1922:

Unsecured domestic loans	\$ 132,560,000
Unsecured foreign loans	239,930,000
Chinese Banks short term debts as approved by the Redemption Commission.	34,500,000
Treasury Notes.	33,700,000
Chinese Banks short term debts	48,250,000
Total	\$ 488,940,000

To this total must be added:

The amount due under the renewed Austrian Loan agreement.

The agreement seems to have been cancelled, but the money is nevertheless still owing to the present bondholders £ 5,200,000

Interest on the whole of the unsecured debt up to July 1923, no settlement of the consolidation question being possible before that date. \$ 25,000,000

The calculations for exchange in the statistics of the Ministry of Finance are not quite safe. The sterling is reckoned at 8 dollars to the pound, whilst the present rate is 9. The rate adopted for the yen is also too low. A conservative estimate would work as follows:

Principal

Debts in silver dollars or Taels reduced into silver dollars	\$ 234,588,000
Debts in sterling £ 3,136,000	
Plus Austrian Loans £ 5,200,000	
Total £ 8,336,000	
at \$9 to the pound	75,024,000
Debts in francs. Fcs 167,500,000	
at fcs 7 to the dollar	23,927,000
Debts in yens. Y 162,655,000	
at \$0.90 to the yen.	146,389,000
Debts in gold dollars. GD 12,342,000	
at \$1.90 to the GD.	23,468,000
Total	\$ 508,396,000

Interest

Interest up to December 31st 1922.	\$ 41,000,000
Interest from January to June 1923.	25,000,000
Grand Total.	\$ 569,396,000

The unsecured indebtedness of the Chinese Government, as it will stand by the middle of the year 1923 may be accordingly put, in round figures, at 570 millions dollars. A large part of the capital of such indebtedness has already matured or will soon mature. Interest is also in arrears. There is no hope of finding sufficient money to satisfy the creditors according to the original contracts. It might even prove impossible to pay them were time only granted, because part of the money has been borrowed at such high rates that the accumulated interest would exceed the future available resources of the Government. Consolidation is imperative as the only way out the difficulty.

Consolidation, as a general proposition, means the redemption of the existing debts through the issue of new bonds, the substitution of new bonds for the old ones involving:

- 1) an extension of time for the short terms debts,
- 2) a reduction of the interest in every case where excessive rates have been charged,
- 3) as a compensation for such extension of time and reduction of interest, the granting of adequate securities.

Consolidation will be a success if sound and reliable security is offered. Creditors whose debts are overdue, or whose debts are shortly to mature, and creditors entitled to high rates of interest under their contracts will certainly agree to accept, in exchange for what is due to them, long term bonds bearing a reasonable rate of interest if payment of interest and repayment of capital are fully guaranteed, that is to say if the pledged revenue is sufficient and sufficiently controlled to secure complete payment of coupons and amortization of the new bonds on due dates.

IV.—The Customs Revenue.

The better the security China can offer her unsecured creditors, the better the terms of the consolidation will be for the Chinese Government.

The best security in China is the revenue of the maritime and native customs under the control of the Inspector General.

Is it possible to secure the consolidation of an indebtedness of about 570 millions dollars on the revenue of the Customs ?

In order to answer the question, let us figure what the future nett revenue of the Customs is likely to be. By *nett revenue* is meant the revenue available for loans and indemnities after the ordinary and extraordinary administrative expenses of the Customs service have been met.

The nett revenue of the Customs for the year 1922 amounted in round figures:

For the Maritime Customs, to	Sh. Taels	52,150,000
For the Native Customs, to	Sh. Taels	4,200,000
Total.		56,350,000
or in dollars at the rate of 73	\$	77,191,500

say *Seventy seven millions dollars*.

The increase to the full 5% which has come into force on the 17th of January 1923 will work only during part of the present year, all goods having left foreign ports prior to such date being charged the old tariff. It may be expected however to give 8 millions dollars in 1923 and 10 millions dollars in 1924.

The raising of the import tariff from 5 % to 7 ½ % for ordinary goods and to 10 % for luxuries may yield 28 millions. As it is unlikely that it may work in 1923, let us reckon it from 1924 only.

Besides, there is a gradual increase of revenue resulting from the natural development of trade. From 1911 to 1922 the average increase has been two millions taels a year. From 1917 to 1922 it is more than three millions taels a year. From 1919, after the last tariff revision, to 1922, it is over four millions taels a year. It is steadily increasing, and with a tariff to be raised from 5 % to 7 ½ and 10 % we may safely anticipate it to be three millions dollars (Taels 2,200,000) a year for the next five years (from 1923 to 1927). After 1927 we may figure it for another ten years at two millions dollars a year.

Working on those data, the probable nett future revenue of the Customs may be calculated as follows:

For the year 1923:

Nett revenue of 1922	\$	77,000,000
Increase from the full 5 % during part only of the year		8,000,000
Increase from development of trade.		3,000,000
Total.	\$	88,000,000

For the year 1924.

Nett revenue of 1923	\$ 88,000,000
Increase from the full 5% during the whole of the year . . .	2,000,000
Increase from new 7½ and 10% tariff	28,000,000
Increase from development of trade	3,000,000
Total.	\$ 121,000,000

For the year 1925:

Nett revenue of 1924	\$ 121,000,000
Increase from development of trade	3,000,000
Total	\$ 124,000,000

For the year 1926:

Nett revenue of 1925	\$ 124,000,000
Increase from development of trade	3,000,000
Total.	\$ 127,000,000

For the year 1927:

Nett revenue of 1926	\$ 137,000,000
Increase from development of trade	3,000,000
Total	\$ 130,000,000

For the year 1928:

Nett revenue of 1927.	\$ 130,000,000
Increase from development of trade	2,000,000
Total.	\$ 132,000,000

and so on till the nett revenue reaches. \$ 150,000,000

But the nett revenue of the Customs is already earmarked for the service of the foreign loans of 1895, 1896 and 1898, of the Boxer Indemnities, of the Reorganization Loan of 1913 and of various domestic loans.

The following table shows what is required for meeting these obligations.

The figures of the foreign loans have been compiled from the official tables of interest and amortization attached to the original loan contracts.

The Boxer Indemnity is calculated at 50 % of its outstanding amount, that is to say less the German, Austrian and Russian shares, with the further assumption that the deferred annuities of the years 1917-1922 are postponed to 1941-1945.

Sterling is calculated at 10 dollars to the pound.

The domestic loans are tabulated in accordance with the official figures published by the Ministry of Finance.

Table I

Table II gives the total of the charges on the Customs Revenue, in dollars, the charges for foreign obligations in gold being converted into silver at the rate of ten dollars to the pound.

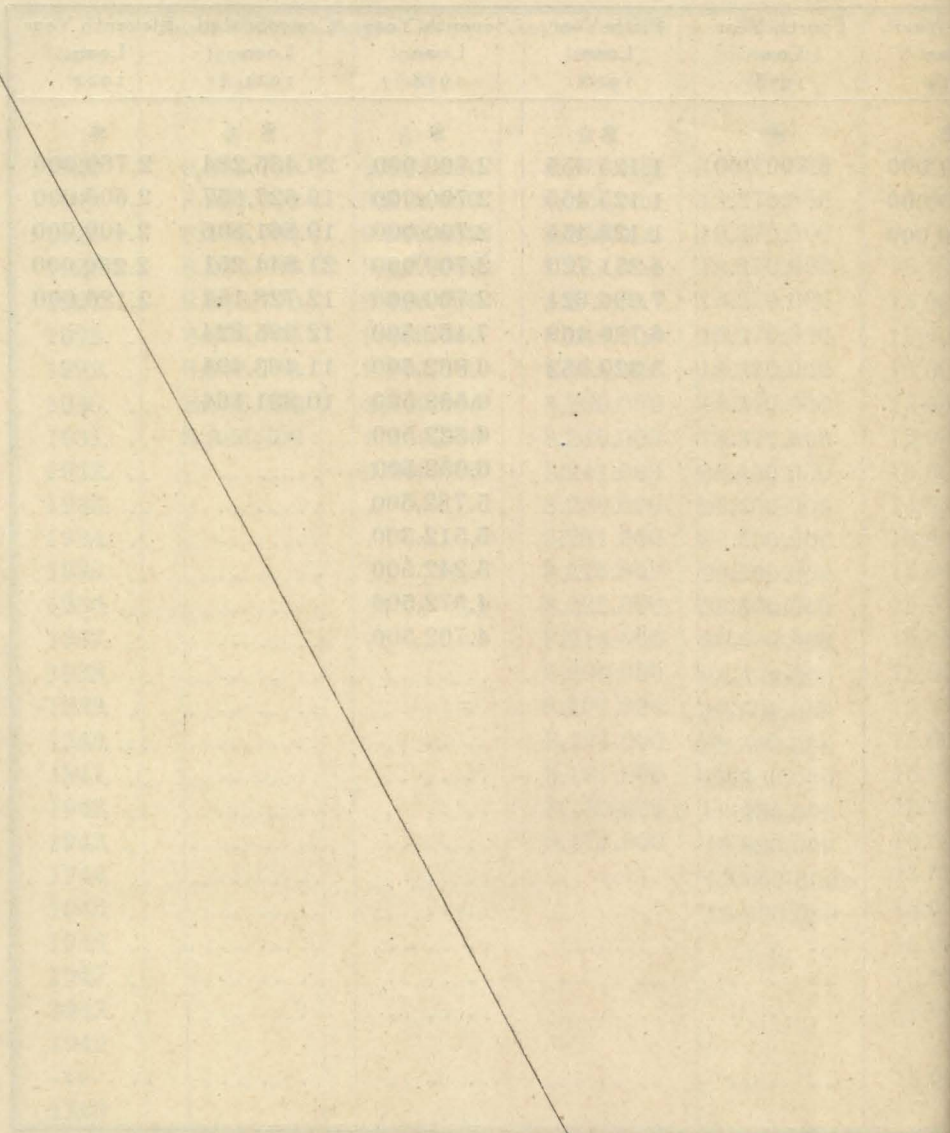


Table II

*Table II***TOTAL CHARGES ON CUSTOMS REVENUE**

Years	Foreign Obligations	Internal Loans	Total
	\$	\$	\$
1923	58.034.700	36.220.739	94.255.439
1924	59.523.700	32.053.112	91.576.812
1925	59.511.700	29.127.260	88.638.960
1926	59.500.700	30.875.971	90.376.671
1927	59.488.700	24.644.775	84.133.475
1928	59.473.700	25.948.793	85.422.493
1929	59.461.700	21.646.046	81.107.746
1930	59.446.700	17.423.664	76.870.364
1931	59.366.000	6.322.500	65.688.500
1932	59.201.000	6.052.000	65.253.500
1933	49.756.000	5.782.500	55.538.500
1934	49.751.000	5.512.500	55.263.500
1935	49.745.000	5.242.500	54.987.500
1936	49.640.000	4.972.500	54.612.500
1937	49.634.000	4.702.500	54.336.500
1938	49.628.000		49.628.000
1939	49.621.000		49.621.000
1940	49.614.000		49.614.000
1941	41.487.000		41.487.000
1942	41.480.000		41.480.000
1943	41.472.000		41.472.000
1944	33.300.000		33.300.000
1945	33.300.000		33.300.000
1946	15.000.000		15.000.000
1947			
to	15.000.000		15.000.000
1960			
1961	nil		nil
1962	nil		nil

Comparing now the figures in Table II with the figures of the probable future revenue of the Customs, as we have worked them out, Table III shows which nett balance may be available for consolidation purposes.

Year	Revenue	Expenses	Balance
1901	10,000,000	10,000,000	0
1902	11,000,000	11,000,000	0
1903	12,000,000	12,000,000	0
1904	13,000,000	13,000,000	0
1905	14,000,000	14,000,000	0
1906	15,000,000	15,000,000	0
1907	16,000,000	16,000,000	0
1908	17,000,000	17,000,000	0
1909	18,000,000	18,000,000	0
1910	19,000,000	19,000,000	0
1911	20,000,000	20,000,000	0
1912	21,000,000	21,000,000	0
1913	22,000,000	22,000,000	0
1914	23,000,000	23,000,000	0
1915	24,000,000	24,000,000	0
1916	25,000,000	25,000,000	0
1917	26,000,000	26,000,000	0
1918	27,000,000	27,000,000	0
1919	28,000,000	28,000,000	0
1920	29,000,000	29,000,000	0
1921	30,000,000	30,000,000	0
1922	31,000,000	31,000,000	0
1923	32,000,000	32,000,000	0
1924	33,000,000	33,000,000	0
1925	34,000,000	34,000,000	0
1926	35,000,000	35,000,000	0
1927	36,000,000	36,000,000	0
1928	37,000,000	37,000,000	0
1929	38,000,000	38,000,000	0
1930	39,000,000	39,000,000	0
1931	40,000,000	40,000,000	0
1932	41,000,000	41,000,000	0
1933	42,000,000	42,000,000	0
1934	43,000,000	43,000,000	0
1935	44,000,000	44,000,000	0
1936	45,000,000	45,000,000	0
1937	46,000,000	46,000,000	0
1938	47,000,000	47,000,000	0
1939	48,000,000	48,000,000	0
1940	49,000,000	49,000,000	0
1941	50,000,000	50,000,000	0
1942	51,000,000	51,000,000	0
1943	52,000,000	52,000,000	0
1944	53,000,000	53,000,000	0
1945	54,000,000	54,000,000	0
1946	55,000,000	55,000,000	0
1947	56,000,000	56,000,000	0
1948	57,000,000	57,000,000	0
1949	58,000,000	58,000,000	0
1950	59,000,000	59,000,000	0
1951	60,000,000	60,000,000	0
1952	61,000,000	61,000,000	0
1953	62,000,000	62,000,000	0
1954	63,000,000	63,000,000	0
1955	64,000,000	64,000,000	0
1956	65,000,000	65,000,000	0
1957	66,000,000	66,000,000	0
1958	67,000,000	67,000,000	0
1959	68,000,000	68,000,000	0
1960	69,000,000	69,000,000	0
1961	70,000,000	70,000,000	0
1962	71,000,000	71,000,000	0
1963	72,000,000	72,000,000	0
1964	73,000,000	73,000,000	0
1965	74,000,000	74,000,000	0
1966	75,000,000	75,000,000	0
1967	76,000,000	76,000,000	0
1968	77,000,000	77,000,000	0
1969	78,000,000	78,000,000	0
1970	79,000,000	79,000,000	0
1971	80,000,000	80,000,000	0
1972	81,000,000	81,000,000	0
1973	82,000,000	82,000,000	0
1974	83,000,000	83,000,000	0
1975	84,000,000	84,000,000	0
1976	85,000,000	85,000,000	0
1977	86,000,000	86,000,000	0
1978	87,000,000	87,000,000	0
1979	88,000,000	88,000,000	0
1980	89,000,000	89,000,000	0
1981	90,000,000	90,000,000	0
1982	91,000,000	91,000,000	0
1983	92,000,000	92,000,000	0
1984	93,000,000	93,000,000	0
1985	94,000,000	94,000,000	0
1986	95,000,000	95,000,000	0
1987	96,000,000	96,000,000	0
1988	97,000,000	97,000,000	0
1989	98,000,000	98,000,000	0
1990	99,000,000	99,000,000	0
1991	100,000,000	100,000,000	0
1992	101,000,000	101,000,000	0
1993	102,000,000	102,000,000	0
1994	103,000,000	103,000,000	0
1995	104,000,000	104,000,000	0
1996	105,000,000	105,000,000	0
1997	106,000,000	106,000,000	0
1998	107,000,000	107,000,000	0
1999	108,000,000	108,000,000	0
2000	109,000,000	109,000,000	0
2001	110,000,000	110,000,000	0
2002	111,000,000	111,000,000	0
2003	112,000,000	112,000,000	0
2004	113,000,000	113,000,000	0
2005	114,000,000	114,000,000	0
2006	115,000,000	115,000,000	0
2007	116,000,000	116,000,000	0
2008	117,000,000	117,000,000	0
2009	118,000,000	118,000,000	0
2010	119,000,000	119,000,000	0
2011	120,000,000	120,000,000	0
2012	121,000,000	121,000,000	0
2013	122,000,000	122,000,000	0
2014	123,000,000	123,000,000	0
2015	124,000,000	124,000,000	0
2016	125,000,000	125,000,000	0
2017	126,000,000	126,000,000	0
2018	127,000,000	127,000,000	0
2019	128,000,000	128,000,000	0
2020	129,000,000	129,000,000	0
2021	130,000,000	130,000,000	0
2022	131,000,000	131,000,000	0
2023	132,000,000	132,000,000	0
2024	133,000,000	133,000,000	0
2025	134,000,000	134,000,000	0
2026	135,000,000	135,000,000	0
2027	136,000,000	136,000,000	0
2028	137,000,000	137,000,000	0
2029	138,000,000	138,000,000	0
2030	139,000,000	139,000,000	0
2031	140,000,000	140,000,000	0
2032	141,000,000	141,000,000	0
2033	142,000,000	142,000,000	0
2034	143,000,000	143,000,000	0
2035	144,000,000	144,000,000	0
2036	145,000,000	145,000,000	0
2037	146,000,000	146,000,000	0
2038	147,000,000	147,000,000	0
2039	148,000,000	148,000,000	0
2040	149,000,000	149,000,000	0
2041	150,000,000	150,000,000	0
2042	151,000,000	151,000,000	0
2043	152,000,000	152,000,000	0
2044	153,000,000	153,000,000	0
2045	154,000,000	154,000,000	0
2046	155,000,000	155,000,000	0
2047	156,000,000	156,000,000	0
2048	157,000,000	157,000,000	0
2049	158,000,000	158,000,000	0
2050	159,000,000	159,000,000	0
2051	160,000,000	160,000,000	0
2052	161,000,000	161,000,000	0
2053	162,000,000	162,000,000	0
2054	163,000,000	163,000,000	0
2055	164,000,000	164,000,000	0
2056	165,000,000	165,000,000	0
2057	166,000,000	166,000,000	0
2058	167,000,000	167,000,000	0
2059	168,000,000	168,000,000	0
2060	169,000,000	169,000,000	0
2061	170,000,000	170,000,000	0
2062	171,000,000	171,000,000	0
2063	172,000,000	172,000,000	0
2064	173,000,000	173,000,000	0
2065	174,000,000	174,000,000	0
2066	175,000,000	175,000,000	0
2067	176,000,000	176,000,000	0
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2069	178,000,000	178,000,000	0
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2072	181,000,000	181,000,000	0
2073	182,000,000	182,000,000	0
2074	183,000,000	183,000,000	0
2075	184,000,000	184,000,000	0
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2086	195,000,000	195,000,000	0
2087	196,000,000	196,000,000	0
2088	197,000,000	197,000,000	0
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2091	200,000,000	200,000,000	0
2092	201,000,000	201,000,000	0
2093	202,000,000	202,000,000	0
2094	203,000,000	203,000,000	0
2095	204,000,000	204,000,000	0
2096	205,000,000	205,000,000	0
2097	206,000,000	206,000,000	0
2098	207,000,000	207,000,000	0
2099	208,000,000	208,000,000	0
2100	209,000,000	209,000,000	0

Table III

Table III

BALANCE AVAILABLE FOR CONSOLIDATION

(In round figures)

Years	Nett Revenue	Charges	Deficit	Surplus
	\$	\$	\$	\$
1923	88.000.000	94.250.000	6.250.000	
1924	121.000.000	91.500.000		29.500.000
1925	124.000.000	88.700.000		35.300.000
1926	127.000.000	90.500.000		36.500.000
1927	130.000.000	84.150.000		45.850.000
1928	132.000.000	85.500.000		46.500.000
1929	134.000.000	81.100.000		52.900.000
1930	136.000.000	77.000.000		59.000.000
1931	138.000.000	66.000.000		72.000.000
1932	140.000.000	65.000.000		75.000.000
1933	142.000.000	55.500.000		86.500.000
1934	144.000.000	55.500.000		88.500.000
1935	146.000.000	55.000.000		91.000.000
1936	148.000.000	55.000.000		93.000.000
1937	150.000.000	54.500.000		95.500.000
1938	150.000.000	50.000.000		100.000.000
1939	150.000.000	50.000.000		100.000.000
1940	150.000.000	50.000.000		100.000.000
1941	150.000.000	41.500.000		108.500.000
1942	150.000.000	41.500.000		108.500.000
1943	150.000.000	41.500.000		108.500.000
1944	150.000.000	33.500.000		116.500.000
1945	150.000.000	33.500.000		116.500.000
1946	150.000.000	15.000.000		135.000.000
1947				
to	150.000.000	15.000.000		135.000.000
1960				
1961	150.000.000	nil		150.000.000

It appears from Table III that a 6,250,000 dollars deficit is to be foreseen for the year 1923, but that there will be a surplus balance of 30 millions dollars in 1924, regularly increasing each year till it reaches 72 millions dollars in 1931. The increase in the balance is due to a large extent to the total of the existing charges dropping from 94,250,000 dollars in 1923 to 66 millions in 1931 and to 55 millions in 1933.

It seems therefore that a consolidation scheme may be based on the Customs Revenue, provided:

a) that means be devised to find some additional funds during the first years, and

b) that interest only on the consolidation bonds be paid up to 1931, redemption beginning in 1932.

The available surpluses from 1932 onwards are sufficient to secure amortization in a short period of time.

V.—A Consolidation Scheme

A mere glance at the tables of the Chinese Foreign and Domestic indebtedness, as published in October 1922 by the Ministry of Finance, shows that the indebtedness consists of a variety of debts, few loans totalling more than ten millions dollars, and most of them being loans of less than one million dollars. The currencies are different, some of the debts being in silver dollars, some in sterling, some in yens, some in francs, etc. The rates of interest and the dates or periods of repayment also widely differ. It seems impossible to consolidate such a mass of heterogeneous obligations with bonds in one single currency, bearing all the same rate of interest, and redeemable under the same conditions.

With regard to the currency, there can be no question of converting the domestic debts in dollars into bonds in a foreign currency. On the other hand, if creditors of debts in foreign currencies are offered bonds in silver dollars, they will point out that the conversion of sterling or gold dollars into Chinese currency involves a risk, and that they will not accept the risk unless conversion is made at a higher rate than the then prevailing exchange quotation. A creditor in sterling for instance may request that his debt be converted into dollars at the rate of eleven to the pound when the market rate is nine only, and so on. The best system, to avoid discussions and losses for the Government, would be to issue as many sets of new bonds as there are different kinds of currencies employed in the loan agreements, say one set in Chinese dollars, one set in sterling, one set in francs, etc., and to offer dollar bonds to the dollar creditors, sterling bonds to the sterling creditors, franc bonds to the franc creditors, etc.

The next point is interest. Most of the unsecured debts bear interest at the rate of 8% or over. In substitution for them, well secured bonds guaranteed on the revenue of the Customs ought to be accepted at lower rates, coupled with a reasonable redemption premium, for instance 7% bonds issued at 87,50 and redeemable at 100. But several of the unsecured debts have been contracted at better terms for China, e. g. the Loans of the Chicago Bank and of the Pacific Development Co at 6%, the French Industrial Loan of 1913 at 5%, the War Participation Loan at 7%. For the 7% loans, 7% bonds ought to be offered at par. As to the 6% and 5% loans, the original terms ought to be preserved or new bonds issued at 6% and 5%.

So much the same for the periods of redemption. The 1913 French Industrial Loan is redeemable in 34 years beginning from 1930. There is no reason to alter the original schedule and to substitute for it a shorter period of amortization. For other loans it may be advisable sometimes to offer bonds redeemable in a longer period. This may facilitate negotiations since the Government has no power to impose consolidation and must discuss terms with each creditor.

Taking into consideration the following facts:

- a) that part of the unsecured indebtedness bears interest at less than 8%;
- b) that when rates over 8% were agreed it was on account of the risk involved in lending money to the Government without proper securities, and that once adequate security is furnished the excessive rates must be lowered;
- c) that the capital of some of the debts may be reduced, since it is disproportionate with the amounts actually received by the Treasury; and
- d) that among the unsecured debts are \$33,700,000 Treasury Notes which the holders never expected to be redeemed in full and on which a substantial rebate may be imposed,

it seems that the total unsecured indebtedness of the Chinese Government, as it will stand by the end of 1923, may be met by the issue of consolidation bonds to a nominal amount not exceeding 625 millions dollars, bearing interest at 7% per year from October 1st 1923, the first semi-annual coupon being payable on April 1st 1924.

The calculation is based on the assumption that the Commission to which the Washington Agreements have entrusted the duty to establish the 2½ Customs surtax will meet and reach a decision before the end of the year.

Now the service of *interest and amortization in twelve years* of a nominal capital of *625 millions dollars* bearing interest at 7% requires \$77,814,000 a year.

Interest alone requires \$ 43,750,000 a year. If it is to run from Octobre 1923 the charge for the year 1923 will be \$ 10,937,500.

From Table III it appears that amortization cannot begin prior to 1932, the surpluses from 1923 till 1931 being sufficient to pay interest only.

Table IV shows how the scheme can work:

Table IV

Table IV

TABLE SHOWING SERVICE OF A CONSOLIDATION 7% LOAN OF 625 MILLIONS
DOLLARS NOMINAL REDEEMABLE IN TWELVE YEARS FROM THE
SURPLUSES OF THE CUSTOMS REVENUE.

Year	Available surplus of the Customs	Service of consolidation Loan	Deficit to be met from other sources	Nett surplus of Customs
	\$	\$	\$	\$
1923	—6.250.000 ⁽¹⁾	10.937 500	17.187.000	
1924	29.500.000	43.750.000	14.250.000	
1925	35.300.000	43.750.000	8.450.000	
1926	36.500.000	43.750.000	7.250.000	
1927	45.850.000	43.750.000		2.100.000
1928	46.500.000	43.750.000		2.750.000
1929	52.900.000	43.750.000		9.650.000
1930	69.000.000	43.750.000		15.250.000
1931	72.000.000	43.750.000		28.250.000
1932	75.000.000	77.814.000	2,814.000	
1933	86.500.000	77.814.000		8.686.000
1934	88.500.000	77.814.000		10.686.000
1935	91.000.000	77.814.000		13.186.000
1936	93.000.000	77.814.000		15.186.000
1937	95.000.000	77.814.000		17.686.000
1938	100.000.000	77.814.000		22.186.000
1939	100.000.000	77.814.000		22.186.000
1940	100.000.000	77,814.000		22.186.000
1941	108.500.000	77.814.000		30.686.000
1942	108.500.000	77.814.000		30.686.000
1943	108.500.000	77,814.000		30.686.000
1944	116.500.000	nil		116.500.000
	etc.	nil		etc.

(1) Deficit

Some persons may think that the above figures are too optimistic. We believe them to be rather conservative. It must be noted for instance that the charges in sterling have been reckoned at ten dollars to the pound. If the present rate under nine dollars maintains as an average during the current year, the sterling charges in 1923 will amount to \$52,000,000 instead of the tabulated \$58,000,000, a decrease of \$6,000,000 which will almost entirely wipe out the initial deficit of \$6,250,000. There is also a probability that the full 5 % and the 2 ½ surtax will bring in more revenue than anticipated.

Anyway, taking the figures in table IV as they stand, the question is to find security for the adverse balances of the years 1923-1926, that is to say in round figures for :

\$ 17,000,000	in 1923
\$ 14,000,000	in 1924
\$ 8,500,000	in 1925
\$ 7,250,000	in 1926.

If the consolidation scheme is executed, all the present indebtedness will be included in it, and consequently all the pledged revenues other than the Customs will be freed from charges. More particularly, there will be no more claims over the surpluses of the Gabelle. It seems then that the said surpluses could be given as additional guarantee for such a period of time as deemed necessary. A maximum of one million 500 thousand dollars per month from October 1923 to June 1925 and one million from July 1925 till the end of 1926 would be sufficient. If the Government would like better to keep the Salt surpluses free of charges so as to be able to dispose of them, no doubt that an arrangement with the Chinese and Foreign Banks may be devised to that effect. Once a sound scheme for a 625 millions consolidation has been agreed upon, there ought to be no difficulty in finding some equitable adjustment for the deficit of the 1923-1926 period, inasmuch as the said deficit will probably be much less in fact than tabulated in table IV.

A method for meeting the possible 1923 deficit would be to have interest on the new bonds running only from January 1924, the nominal capital being proportionately increased. The Government might also consider the advisability of altering the amortization tables of the *National Consolidated Debt Service* created in 1921. A two years postponement of the redemption of some of the loans included in that service might easily procure a balance of two or three millions a year in 1924 and 1925.

VI.—Main Characteristics of the Proposed Consolidation Scheme.

1° No distinction is made in the scheme between the domestic and the foreign indebtedness. The idea is to treat all creditors of the Chinese Government alike and give them the same reliable security, whether they are Chinese citizens or firms, or nationals of Foreign Powers. It is a question of fairness and justice. It is also to the best interest of the country. The purpose of the consolidation is to restore China's credit. Such credit would not be restored if part of the indebtedness of the Chinese Government would remain unsecured, or unpaid, or irregularly paid. It has become essential for the Chinese Government that the investing public should make no distinction between China's internal and external credit, the external credit being considered as sound and the internal credit as bad or doubtful. When part of the credit of a country is doubtful, the whole of such credit is affected thereby. The Chinese Government must look forward for the time when they will be able to borrow money without having to give specific sources of revenue as guarantee: the first step towards such progress is regular and punctual performance of *all Government obligations*.

2° The effect of the consolidation, when completed, will be to substitute the Customs Revenue and the Salt Revenue for all the other pledged revenues. There will be no more foreign or domestic charges on the Wine and Tobacco tax, on the Stamp duty, on the Octroi, on the Title Deeds tax, etc. The Chinese Government will recover full rights over these various sources of revenue. Besides, the Salt Revenue will be pledged only for a few years and for a comparatively small amount. All the present creditors being satisfied, the Ministry of Finance shall not be any more pressed by their incessant demands for funds, and may devote its time and energy to the study of the most important financial problems.

3° A necessary condition for the success of any consolidation scheme based on the Customs Revenue is that all the *nett revenue* after payment of the expenditure of the Customs administration be appropriated by preference for the service of the consolidation bonds. No other expenditure to take precedence over the payment of interest and amortization of the said bonds. Consequently, the appropriations which have already been granted for the Wai Chiao Pou and for other such Government Departments, or which may be granted in future shall be paid only on the surplus remaining *after* payment of the interest and amortization of the consolidation bonds. If Government expenditure of whatever sort were allowed to take precedence over the consolidation bonds, the security of these bonds would be impaired, and the whole scheme would fail.

Since however the result of the consolidation would be to put most of the Salt surpluses at the disposal of the Government, the said expenditure might be made payable by preference from the said surpluses.

4° In connection with the above remark, it must be noted that "appropriations" out of the increase resulting from the full 5% tariff or out of the increase resulting from the 2½% surtax are not feasible. No separate accounts of the increase are to be kept by the Customs administration. The proceeds of the old tariff and of the increased tariff are to be received in one single account since they are to be paid by the importers in a lump sum. A merchant who imports in 1924 articles valued \$1000 will not be charged by the Customs \$35 for the old tariff, plus \$15 for the full 5%, plus \$25 for the 2½% surtax. He will be charged \$75 odd and the entry in the books of the Customs will be an entry for \$75. No subdistinctions will be made in the accounts and it will be impossible to charge in the accounts a particular expense to a particular portion of the revenue.

5° The question of a future increase of the tariff up to 12 ½ % as compensation for the abolition of *likin* has been entirely left out of the present Memorandum. The suppression of the *likin* cannot be carried out until the relations between the Central Government and the Provinces have been clearly defined and an agreement has been reached as to which revenue shall belong to the Government and which to the Provinces. Besides, it is admitted that the increase up to 12 ½ % will only compensate for the losses resulting from the suppression of the *likin*. The reform is not intended to procure additional revenue to the State and cannot be used for purposes of consolidation.

6° The question of the unpaid railway loans has also been left out of the Memorandum because these loans are secured on the railways themselves with additional specific guarantees and because their service may be met from the railways receipts.

January 23rd 1923.